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SUBJECT: SUPREME COURT RULING AGAINST TAX ON PENSIONS TRIGGERS
POLITICAL TURMOIL

¶1. Summary: A ruling in March 2008 by the Supreme Court that declared as unconstitutional a new tax on pensions has triggered unprecedented attacks on the Judiciary and caused significant political turmoil. So far, the GOU has refused to revoke the tax, in a stance that is being harshly criticized by the opposition. Since the Supreme Court's ruling was a close 3-2 vote and one of the judges who opposed the tax retired in April, the GOU is gambling that the new Justice will tip the balance of the Court in its favor.

Should this not be the case, however, the opposition would press the GOU even harder to revoke the tax. In such a scenario, the GOU would have to slash expenditures or postpone announced tax cuts, both moves politically costly. The new personal income tax, which includes the tax on pensions, has been a bone of contention for months. The noisy debate on the tax reform, already a daily highlight in the media, is expected to gain additional traction in the electoral campaign and could hamper the Frente Amplio's chances of winning the 2009 elections in the first round. End Summary.

Unprecedented pressures on the Judiciary

¶2. On March 26, prominent members of the Socialist Party accused Judge Sara Bossio, one of the five Supreme Court justices, of showing bias in a recent ruling against a tax on pensions. In a March 28 press conference, Senator Fernandez Huidobro, an influential member of the MPP, the largest faction within the ruling Frente Amplio, bluntly expressed his discomfort with the inner workings of the Supreme Court, claiming that two justices had intentionally delayed their opinion for the final ruling. At an April 6 demonstration, MPP Senator and former Agriculture Minister Mujica criticized the Supreme Court's decision and warned judges against judicial activism. On April 9, MPP Congressman Perez accused the Supreme Court of lack of independence and of bias towards the wealthy. He then went on to threaten to cut the Judiciary's budget. Perez's statements found no echo in the Frente Amplio and were strongly rejected by the opposition. The local Association of Judges reacted promptly to his statements and announced on April 11 that it would file a complaint against him before the UN's Special Rapporteur of the Commission of Human Rights on the Independence of Judges and Lawyers.

A 3-2 vote in the Supreme Court

¶3. The detonator for these unprecedented attacks on the Judiciary --especially in a country proud of its longstanding division of powers and the independence of its Judiciary-- was the Supreme Court's ruling that found a new tax on pensions to be unconstitutional. The Parliament had approved in January 2007 a major tax reform which, among other things, imposed a tax on personal income including wages and pensions. The tax reform went into effect in July 2007. Immediately after passage of the tax reform, several thousand retirees filed some 360 cases before the Supreme Court, claiming that the tax on pensions was unconstitutional. From March 26 through April 7, 2008, the Supreme Court ruled on 15 of the 360 cases that had been presented, and concluded in a 3-2 vote that the tax on pensions was unconstitutional. Abiding by an article included in a 1997

constitutional reform, the three-judge majority ruled that pensions are different from salaries, since they are an acquired right, and cannot be taxed in any way. In turn, the two judges in the minority referred to a 1997 Supreme Court ruling that had declared an earlier tax on pensions to be constitutional.

Opposition criticizes GOU's decision to wait and see

¶4. The GOU has delayed revocation of the tax to comply with the ruling and remains in a wait-and-see mode, until retiring Supreme Court Justice Sara Bossio's replacement is appointed and the new Supreme Court rules on more cases. The GOU hopes that the new Justice will back the tax and thus alter future rulings in its favor. (Note: The Supreme Court is not empowered to revoke a law and rules on a case-by-case basis. End Note.) For all practical purposes, the new Justice will determine the fate of the tax on pensions, which is expected to net about \$100 million a year, or about two percent of the GOU's revenues. (Comment: If the tax on pensions is repealed and the GOU wants to stick to the fiscal discipline it has shown so far, it would have to slash expenditures or postpone announced cuts in the personal income tax, both of which would be politically costly. End Comment.) Since the first rulings were passed on March 26, the opposition --led by Blanco leader Senator Larranaga and former presidents Lacalle and Sanguinetti-- has harshly criticized the GOU's refusal to revoke the tax and has accused the administration of arrogance and disrespect for the Judiciary.

In the meantime, political turmoil continues

¶5. The upcoming appointment of a new Justice has generated significant political turmoil, as the GOU tries to garner the two-thirds majority required in Parliament. Negotiations with the opposition appear at a dead-end, with President Vazquez rejecting Larranaga's demand that the GOU revoke the tax as a "gesture of good will." Should no agreement be reached within a 90-day period, the oldest judge of any Court of Appeals (CoA) would automatically fill in as the new Justice. In the meantime, the Supreme Court will have to distribute over 300 pending cases randomly among members of the Court of Appeals. The GOU is trying to avoid this random distribution of cases, as it could result in different rulings for each case and create significant legal uncertainty.

¶6. On April 15, the GOU counterattacked by convoking a General Assembly of Parliament for April 22, at which time it will propose as new Justice the same judge that would be automatically appointed if no agreement is reached within a 90-day period. With this move, the GOU is putting the opposition on the spot by making them look to be acting irresponsibly and prolonging the uncertainty, should they refuse to support the GOU's nominee candidate. According to press reports, the proposed Justice believes that the tax on pensions is constitutional which, if true, would tip the balance within the Supreme Court in favor of the GOU's position on this issue.

Interest groups take a stand on the conflict

¶7. Leaks of the Supreme Court's ruling long before the decision was made public (including the detailed arguments of each Justice) received massive press coverage and set-off considerable political turmoil that gradually spread to other interest groups. On April 2, two organizations of pensioners gathered in support of the Supreme Court and accused the GOU of disloyalty. In an April 9 speech delivered during a national strike before a large gathering of pensioners, representatives of the powerful umbrella union PIT-CNT urged the GOU to modify the general income tax by mid-year. (Note: In a March 10 speech, President Vazquez had said that no modification would be made to the personal income tax until Parliament passes the annual budget and the GOU has a clearer picture of personal income tax collection. End Note.) On April 14, the leader of the small Partido Independiente began contacts with the opposition and the Frente Amplio with a view to organize a demonstration in favor of "the independence of the Judiciary and the separation of powers".

Comment: Tax debate narrows FA's chances of reelection

¶8. The opposition is reading the Supreme Court ruling as its first

victory over the Frente Amplio government, which reacted late and in an aggressive manner that showed little tolerance for dissent. The personal income tax, including the tax on pensions, is a bone of contention that is likely to continue to gather steam throughout the electoral campaign. While Economy (Finance) Minister Astori argues that over 80% of retirees will pay lower taxes, general opposition within the middle class with the new taxes on incomes and pensions is sure to narrow his chances for the 2008 elections, should he be a candidate, as he is closely associated with the tax reform. The opposition is likely to continue to exploit the Frente Amplio's reluctance to revoke the tax on pensions to paint it as arrogant, stubborn and showing little respect for the Judiciary. Should this argument take hold among pensioners (about 600,000 in a 3.3 million population), it would certainly reduce the Frente Amplio's chances of winning in the first round of the 2009 general elections and perhaps altogether, if the opposition can unite. The GOU is in a tough spot and the opposition is taking full advantage of it. End Comment.

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